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Current Support Brief

MONEY SUPPLY AND THE PRICE LEVEL
IN SOUTH VIETNAM



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MONEY SUPPLY AND THE PRICE LEVEL
IN SOUTH VIETNAM

Although there are inflationary pressures within the economy of South Vietnam, the price level so far in 1964 has remained surprisingly stable. The money supply index (1955 = 100) rose 91 points between 1959 and May 1964, but the working-class consumer price index rose only 18 points during the same period. Government deficit financing has been the major cause of the increase in the money supply since 1960. Continuing budget deficits and net additions by the private sector are expected to result in an increase of 13.8 billion piasters* in the money supply from January 1964 to July 1965. Of this increase, approximately 4.8 billion piasters represent an inflationary gap that could produce an upward price spiral.

Continued price stability depends primarily on the level of confidence of the business community and consumers in the value of the piaster. Such confidence is sustained by higher levels of US commodity import aid designed to fill the inflationary gap.

1. Price Level

Consumer price indexes for the first quarter of 1964 were unchanged or down slightly from December and followed basically the normal seasonal patterns. 1/ The general index of consumer prices for Vietnamese working-class families in Saigon (1959 = 100) stood at 116 in March (see the chart) compared with 117 in December 1963. 2/ The component indexes show clothing, rent, and utilities up during the quarter, while food remained stable. The latest available data show that during April and May the working-class consumer price index stood at 118. 3/ In 1963 the general index rose 5 points from January to a level of 117 in December. 4/

2. Money Supply

The money supply in May was 24.6 billion piasters, or 11 percent above the beginning of the year. From 1960 through 1963 the level rose at an average annual rate of about 10 percent. 5/ The major causes of the monetary expansion during 1960-62 were increases in bank credit

* There is no one meaningful rate of exchange for the piaster. However, the rate of exchange at which the US-financed Commodity Import Program is calculated is 70 piasters to US \$1.

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to both the government and the private sector. Credit to the private sector rose during this period at an average of 1.1 billion piasters a year, and credit to the government rose at an average of 0.8 billion piasters. 6/ Additional Central Bank credit to the government during 1963 and 1964 to finance increased defense expenditures is now the primary expansionary factor affecting the money supply. Central Bank advances increased by 2.6 billion piasters between January 1963 and January 1964. 7/ An increase of 750 million piasters in foreign exchange holdings by the Central Bank 8/ during 1963 provided an additional expansionary element.

Government expenditures through the first half of 1965 are now expected to result in a budget deficit of about 9.9 billion piasters for the 18-month period beginning in January 1964. 9/ Credit expansion by the private sector is expected to be about 3.6 billion piasters during the period. A net increase of 0.3 billion piasters is expected on foreign accounts. It is estimated, therefore, that from 1 January 1964 to 1 July 1965 the net increase in the money supply will be about 13.8 billion piasters. 10/

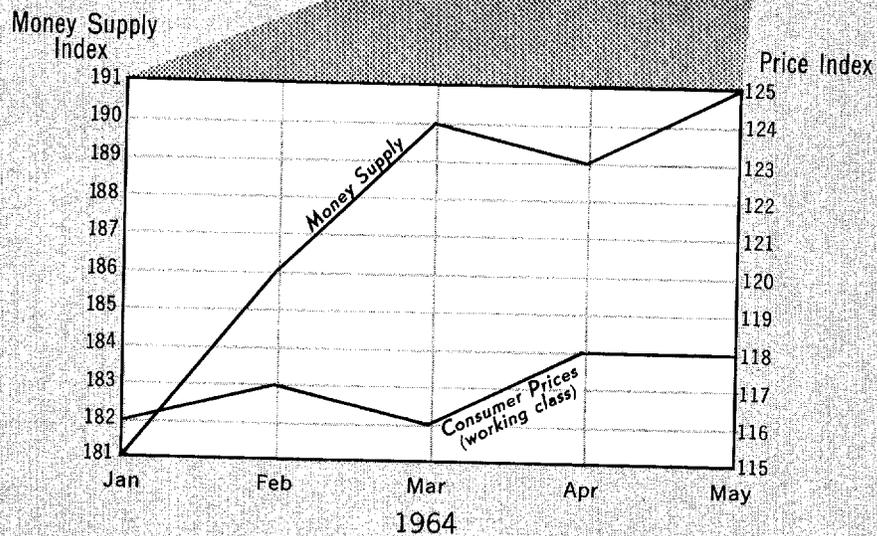
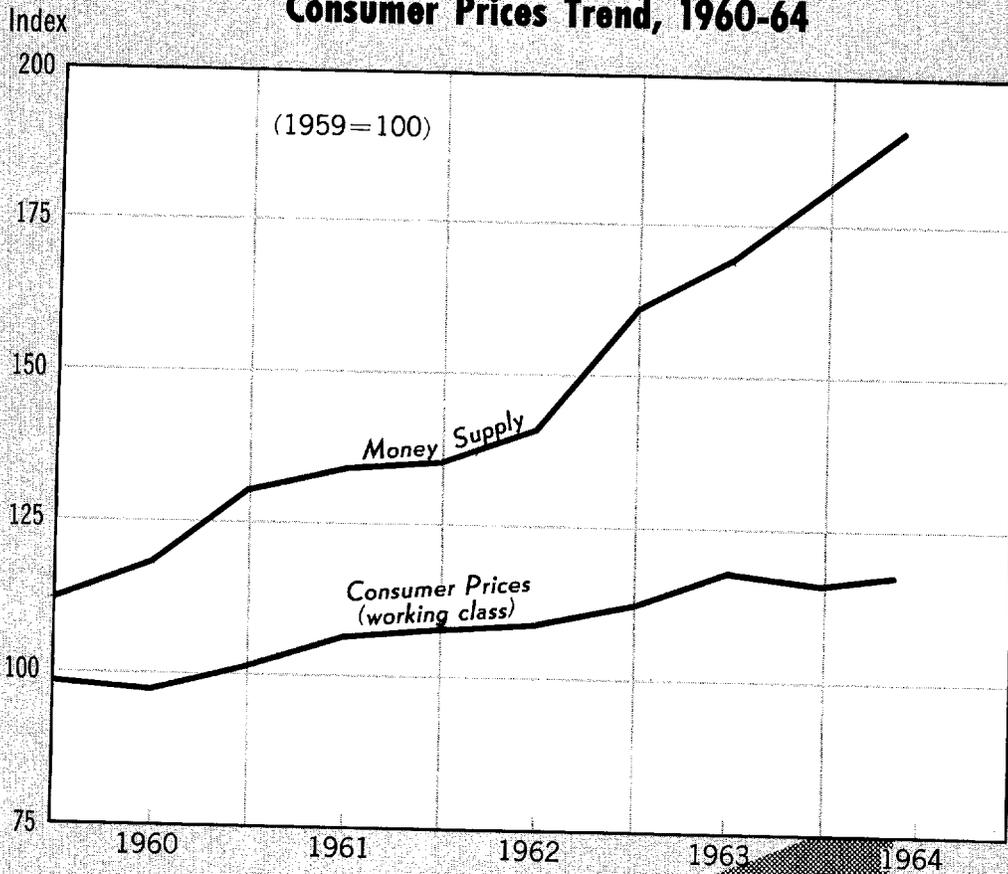
3. Inflationary Potential

With the expansion in the money supply caused primarily by large budget deficits, pressures probably will continue in 1964 and 1965 toward higher price levels in Saigon. The absence so far of a clear correlation between the expansion of the money supply and trends in the general price index appears in part to result from the fact that larger cash hoards and transactions balances are held by the private sector as the money supply increases. It is expected that these balances held by businessmen and consumers will increase by nearly 5 billion piasters during the period and will offset a large part of bank credit additions to the money supply. 11/

It is estimated further that an additional \$1 billion piasters will be held in the provinces as cash balances because the security situation makes purchases difficult. Purchases of consumer durables such as tools and implements provide evidence to the Viet Cong of taxable capacity among the villagers. In addition, because a considerable segment of the Vietnamese economy is not yet fully monetized, an estimated increase of 1 billion piasters will be held by persons who live predominantly outside the sphere of monetary transactions.

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SOUTH VIETNAM: Money Supply and Consumer Prices Trend, 1960-64



Of the increase of 13.8 piasters in the money supply by July 1965, it is estimated that approximately 6.8 billion piasters represent inflationary potential. Increases in population and production probably will absorb at least 2 billion piasters, leaving an inflationary gap of about 4.8 billion piasters.

4. Role of US Aid

Whether the inflationary pressures can be contained in South Vietnam depends primarily on whether the confidence of consumers, and especially the Vietnamese business community, can be sustained. Even in the face of a high level of urban unemployment and declining rates of investment, businessmen in Saigon at present appear to have confidence in the continued strength of the piaster. Such confidence, however, is sustained mainly by an adequate supply of US-financed imports at stable prices. The US-financed Commodity Import Program for fiscal year 1964 is approximately US \$113 million. 12/ Increased US commodity and development aid in fiscal year 1965 is predicated on the necessity of eliminating dangerous inflationary pressures and of maintaining future confidence in South Vietnam's economic stability.

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